

February 1989

FINANCIAL AUDIT

Examination of EPA's
Financial Statements
for Fiscal Year 1987



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**Comptroller General
of the United States**

B-216351

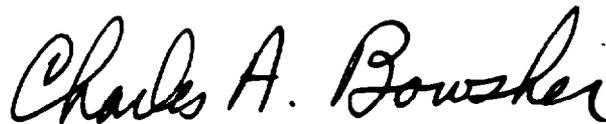
February 9, 1989

To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our examination of the Environmental Protection Agency's (EPA) consolidated financial statements for the fiscal year ended September 30, 1987. Our report discusses a limitation on the scope of our examination due to an inability to audit opening account balances as of October 1, 1986, the result of which was to limit our opinion to EPA's consolidated statement of financial position as of September 30, 1987. Our opinion is qualified due to our concerns about the fair presentation of EPA's land, buildings, and equipment.

This report contains separate reports on EPA's system of internal accounting controls and on its compliance with laws and regulations. Our study and evaluation of internal accounting controls disclosed (1) an inadequate use of reconciliation as an internal control procedure for ensuring the propriety of reported account balances and (2) internal control weaknesses in EPA's accounting for and control over property. EPA has not routinely reconciled its general ledger balances to external sources and subsidiary records. EPA's property management systems and records, which serve as the accounting subsidiary for capital assets, do not provide information needed to account for capital assets and are not subject to adequate internal controls. For transactions we tested, EPA complied with the provisions of laws and regulations which could have materially affected its financial statements.

We are sending copies of this report to the Director of the Office of Management and Budget, the Secretary of the Treasury, and the Administrator of the Environmental Protection Agency.



Charles A. Bowsher
Comptroller General
of the United States

Contents

Letter	1
Opinion Letter	4
Report on Internal Accounting Controls	8
Accounting Records Are Not Adequately Reconciled	10
Property Assets Are Not Adequately Accounted For and Controlled	12
Conclusions	15
Recommendations	15
Other Opportunities for Improvement	16
Agency Comments	16
Report on Compliance With Laws and Regulations	18
Financial Statements	19
Consolidated Statement of Financial Position	19
Consolidated Statement of Revenues and Expenses	20
Consolidated Statement of Changes in Financial Position and Reconciliation to Budget	21
Notes to Financial Statements	22
Supplemental Schedules	31
Schedule of Financial Position by Fund Activity	32
Schedule of Revenues and Expenses by Fund Activity	33
Schedule of Changes in Financial Position and Reconciliation to Budget by Fund Activity	34

Abbreviations

EPA	Environmental Protection Agency
FMFIA	Federal Managers' Financial Integrity Act
FMSD	Facilities Management and Services Division
OMB	Office of Management and Budget
PPAS	Personal Property Accounting System

**Comptroller General
of the United States**

B-216351

To the Administrator
Environmental Protection Agency

We have examined the consolidated statement of financial position of the Environmental Protection Agency (EPA) as of September 30, 1987, and the related consolidated statements of revenues and expenses and of changes in financial position and reconciliation to budget for the fiscal year then ended. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, except as indicated in the following two paragraphs. In addition to this opinion, we are also reporting to you on our study and evaluation of EPA's internal accounting controls and on its compliance with laws and regulations.

Fiscal year 1987 represents the first year that EPA has prepared consolidated financial statements in accordance with generally accepted accounting principles for federal agencies. Because our examination did not commence until July 1987, it was not practical to perform various auditing procedures with respect to determining whether, as of the beginning of fiscal year 1987, assets, liabilities, equity, revenues, and expenses were recorded in the proper accounting period. Accordingly, we do not express an opinion on the accompanying consolidated statements of revenues and expenses and of changes in financial position and reconciliation to budget or on the consistency of application of accounting principles with the preceding year.

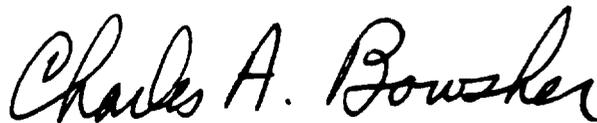
Conditions exist with respect to EPA's property accounts which represented departures from generally accepted accounting principles and internal control standards for federal agencies. These conditions include the manner in which EPA accounts for and supports property asset balances and weaknesses in the internal control system it utilizes to control and safeguard property assets. For example, EPA's property records do not provide the cost and depreciation data needed to account for property assets. In addition, EPA's property asset balances were not supported by adequate documentation or subject to periodic reconciliations. Because of these conditions, it was not practical to perform, nor did we perform, auditing procedures necessary to satisfy ourselves as to the aggregate net book value of land, buildings, and equipment reported on the consolidated statement of financial position as of September 30, 1987.

The Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986, created a trust fund to help EPA respond to hazardous substances that threaten human health and the environment. The principal financing sources for the trust fund are taxes on petroleum and chemicals, an environmental tax on corporations, costs recovered from responsible parties, fines and penalties, and earned interest. The Congress provides, in annual appropriations, the amounts EPA may expend from the trust fund. EPA accounts for and reports on only those funds the Congress has appropriated. As part of its Superfund program activities, EPA has inventoried over 30,000 sites which may pose a threat to human health or to the environment. Over 1,100 of these sites are currently on a priority list, making them eligible for Superfund remedial actions. The ultimate cost to address all potential sites requiring remedial action is unknown and, as a result, it is unclear whether the \$8.5 billion currently authorized for the 5-year period beginning with fiscal year 1987 will be adequate.

In our opinion, except for the effects of adjustments, if any, on the consolidated statement of financial position as might have been necessary had we been able to satisfy ourselves as to the aggregate net book value of land, buildings, and equipment, as discussed in paragraph three, the accompanying consolidated statement of financial position presents fairly the financial position of the Environmental Protection Agency as of September 30, 1987, in accordance with generally accepted accounting principles for federal agencies.

Our examination was made for the purpose of forming an opinion on the consolidated statements taken as a whole. The supplemental schedules of financial position by fund activity, of revenues and expenses by fund activity, and of changes in financial position and reconciliation to budget by fund activity are presented for the purposes of additional analyses and are not a required part of the basic financial statements. The supplemental schedule of financial position by fund activity has been subjected to the same auditing procedures applied in the examination of the consolidated statement of financial position. In our opinion, except for the effects of the matters discussed in paragraph three above, the supplemental schedule of financial position by fund activity is fairly

stated in all material respects in relation to the consolidated statement of financial position taken as a whole. For reasons expressed in the second paragraph, we do not express an opinion on the supplemental schedules of revenues and expenses by fund activity and of changes in financial position and reconciliation to budget by fund activity.



Charles A. Bowsher
Comptroller General
of the United States

July 1, 1988

Report on Internal Accounting Controls

We have examined the consolidated financial statements of the Environmental Protection Agency (EPA) for the fiscal year ended September 30, 1987, and have issued our opinion thereon. As part of our examination, we made a study and evaluation of the system of internal accounting controls to the extent we considered necessary to evaluate the system as required by generally accepted government auditing standards.

The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the agency's consolidated financial statements. For purposes of this report, we have classified the significant internal accounting controls into the following categories:

- budget,
- obligations,
- disbursements,
- grants,
- payroll,
- property,
- receivables and receipts, and
- financial reporting.

Our study and evaluation included all of the control categories listed above, except we did not evaluate the internal accounting controls over all functions within each category because it was more efficient to expand our substantive audit tests.

While planning the timing and extent of our audit work, we became aware of internal control testing being performed by Leonard G. Birnbaum and Company, Certified Public Accountants, as part of its financial and compliance audit of EPA's fiscal year 1987 obligations and disbursements charged to Superfund appropriations. We reviewed and evaluated its internal control testing and concluded that we could rely on its control testing and results to augment ours. Accordingly, we have, where appropriate, incorporated its findings and recommendations in our report.

EPA's management is responsible for establishing and maintaining a system of internal accounting controls in accordance with the Accounting and Auditing Act of 1950 and the Federal Managers' Financial Integrity Act of 1982 (FMFIA). In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of internal control procedures. The objectives of a system

of internal accounting controls are to provide management with reasonable assurance that (1) obligations and costs are in compliance with applicable laws, (2) funds, property, and other assets are safeguarded against waste, loss, and unauthorized use or misappropriation, and (3) assets, liabilities, revenues, and expenditures applicable to the agency's operations are properly recorded and accounted for to permit the preparation of reliable financial and statistical reports and to maintain accountability over the agency's assets. Because of the inherent limitations in any system of internal accounting controls, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions or that the degree of compliance with procedures may deteriorate.

In accordance with FMFIA, EPA reviewed and reported on its systems of internal accounting and administrative controls for fiscal year 1987. We reviewed the report and considered the weaknesses it noted in determining the nature, timing, and extent of our internal control tests.

Our study and evaluation of EPA's system of internal accounting controls, made for the limited purpose described in the second paragraph, would not necessarily disclose all weaknesses in the system. Accordingly, we do not express an opinion on EPA's system of internal accounting controls taken as a whole or on any of the categories of controls identified in the second paragraph. However, our study and evaluation of internal accounting controls disclosed conditions which we believe contributed to material misstatements in EPA's unaudited financial statements submitted to the Department of the Treasury for fiscal years 1986 and 1987 and in its financial report submitted to the Office of Management and Budget (OMB) for fiscal year 1986. These conditions relate to weaknesses in EPA's reconciliation processes and inadequacies in EPA's property management records. EPA has not routinely reconciled its general ledger balances to external sources and subsidiary records as a means of maintaining accurate account postings and substantiating general ledger balances and financial reports. EPA's property management records, which serve as the subsidiary accounting system for capital assets, (1) do not provide information needed to account for capital assets and (2) are not subject to adequate internal controls. In addition, EPA was unable to provide the supporting documentation needed to audit the fair presentation of its land and buildings account balances. As a result of these weaknesses in accounting for and controlling property, we qualified our opinion on EPA's statement of financial position, as it

was not practical to perform auditing procedures necessary to satisfy ourselves as to the fair presentation of EPA's property assets. EPA's audited financial statements have been adjusted to correct the material misstatements associated with not routinely reconciling its general ledger balances.

Accounting Records Are Not Adequately Reconciled

Our review of EPA's accounting and financial reporting operations found that the agency did not routinely reconcile its general ledger accounts with available external sources and subsidiary records. We believe that the inadequate use of reconciliation as an internal control contributed to material misstatements in EPA's unaudited financial statements submitted to Treasury for fiscal years 1986 and 1987 and its financial report submitted to OMB for fiscal year 1986.

The process of timely reconciliation is an important and effective internal accounting control procedure for detecting errors in the general ledger and supporting accounting records and, thus, helps to substantiate and maintain the accuracy of account postings and balances. Both GAO's Policy and Procedures Manual for Guidance of Federal Agencies (title 2, appendix II) and EPA's Accounting Manual require periodic reconciliations as a basis for ensuring the accuracy of general ledger balances. Without accurate and reliable accounting records, it becomes more difficult to properly manage and maintain accountability over financial operations and reporting.

By not reconciling general ledger balances to available external sources and subsidiary records, agency management is denied reasonable assurance that transactions are properly accounted for and that financial statements and reports are accurate. In examining EPA's internal controls over financial reporting, we compared the general ledger balances with EPA's official financial statements and reports for fiscal years 1986 and 1987. Although we did not perform the kind of reconciliations that should have been performed by EPA, we investigated why unexplained differences existed. The results of our investigation included the following:

- At the end of fiscal year 1986, EPA's general ledger cash balance for Superfund was \$1,077 million, while the Superfund cash balance maintained by Treasury was \$528.8 million. EPA did not reconcile the \$548.2-million difference, which we found to be primarily caused by EPA's not recording a \$600-million rescission in budget authority. In its official fiscal year 1986 Treasury Report on Financial Position (TFS 220), EPA

reported a third number, \$28.6 million, for the Superfund cash balance. EPA officials were unable to identify the source of the \$28.6-million balance and could not explain why it differed from both the Superfund cash balance recorded in its general ledger and from that balance maintained by Treasury.

- At the end of fiscal year 1986, EPA's general ledger cash balance for its general fund was \$9,209 million, while, in its official Treasury Report on Financial Position (TFS 220), EPA reported a general fund cash balance of \$9,393 million. EPA did not reconcile the \$184-million difference, which we found to be primarily caused by EPA's not closing its general ledger disbursement account at the end of fiscal year 1986.
- At the end of fiscal year 1987, EPA's general ledger balance for receipts with Treasury was \$37.3 million, while the receipt balance maintained by Treasury was \$26.6 million. EPA did not reconcile the difference, which we found to be primarily caused by EPA's not closing this receipt account at the end of fiscal year 1986 when it had a balance of approximately \$12 million. While EPA correctly reported the \$12-million receipt account balance as revenue in its fiscal year 1986 Treasury Report on Operations (TFS 221), not closing the receipt account meant the balance was carried forward. Consequently, EPA reported the same \$12 million in receipts as revenues in its report on operations for fiscal year 1987.

Because EPA did not reconcile its general ledger balances with its financial reports and the related balances maintained by Treasury, the errors noted above were not detected in time to prevent material misstatements of balances in the agency's report to OMB for fiscal year 1986 and in its financial statements to Treasury for fiscal years 1986 and 1987. To correct these errors, EPA made adjustments totaling more than \$789 million to its consolidated financial statements at the end of fiscal year 1987.

EPA's ineffective use of reconciliation as an internal accounting control was not limited to material general ledger balances. We found that EPA did not reconcile its general ledger balances for imprest funds and accounts receivable with available supporting records. While these asset accounts are not material to the agency's consolidated financial statements, they are, nonetheless, highly sensitive assets, which are vulnerable to misappropriation, loss, and abuse, if not subject to adequate internal accounting controls.

Property Assets Are Not Adequately Accounted For and Controlled

Our review of EPA's general ledger balances for property totaling \$320.6 million disclosed material weaknesses in EPA's property management records which serve as the basis for accounting and controlling property assets. These weaknesses include the following: (1) the inability of the property management records to provide financial information, such as cost and depreciation data, needed to account for personal property assets in accordance with generally accepted accounting principles for federal agencies, (2) the ineffective control over EPA's personal property assets, and (3) the lack of supporting documentation for EPA's land and buildings.

GAO's Policy and Procedures Manual for Guidance of Federal Agencies (title 2, appendix I, "Accounting Principles and Standards"), which presents generally accepted accounting principles for federal agencies, and OMB's Financial Management and Accounting Objectives require that property records provide accountability for assets by maintaining financial information needed to account for and control property. Property records should provide financial information, such as type of asset, date of acquisition, cost, estimated useful life, applicable depreciation data, physical location, and identity of custodial officers. Without accurate accounting and property management records, it is difficult to properly manage and maintain accountability for property assets. In addition, financial information must be reliable in order to maximize its usefulness to agency management in making decisions regarding agency programs and operations.

We identified significant weaknesses in EPA's ability to account for and report personal property financial information in accordance with title 2. These weaknesses include the following:

- The Personal Property Accounting System (PPAS), which serves as the property control system as well as the subsidiary accounting system for the general ledger personal property accounts, does not provide the data needed to account for assets, including the type of asset, cost, dates of acquisition, estimated useful lives, and applicable depreciation data.
- Instead of capitalizing property when purchased, all disbursements for property are initially charged to the operating expense account. At fiscal year-end, a manual adjustment is made to the general ledger to bring it into agreement with the year-end PPAS balance for capital property. By not capitalizing property in the general ledger when purchased, EPA must rely on a year-end manual adjustment to its general ledger to record annual capital property additions.

-
- For fiscal years 1986 and 1987, EPA did not reconcile personal property disbursements for equipment with the subsidiary records that support the general ledger property asset balances. This lack of reconciliation was caused, in part, by the fact that the accounting system and PPAS are not integrated and do not have a common data element or interface which would facilitate a reconciliation.

EPA's method of accounting for property assets and its practice of not reconciling property disbursements and general ledger asset balances to supporting subsidiary records have contributed to material errors in the agency's accounting records and Treasury financial statements. Some examples follow:

- For fiscal year 1986, EPA's Treasury Report on Financial Position included over \$43 million in capital property that was not recorded in EPA's year-end general ledger. We believe that EPA's method of accounting for capital property with its total reliance on a manual year-end adjustment to record yearly capital additions contributed to the \$43 million not being recorded in the year-end general ledger.
- For fiscal year 1987, EPA's Treasury Report on Cash Flow overstated property-related disbursements by over \$68 million. We believe that EPA's practice of initially charging capital property to operating expenses and not reconciling its property-related disbursement data with its subsidiary accounting system (PPAS) contributed to not detecting the overstatement.

Since the close of fiscal year 1987, EPA's Financial Management Division has taken action to improve its accounting for equipment by reconstructing the equipment-related general ledger balance using historical financial management system expenditure data. However, this effort does not address the inadequacies of PPAS as a subsidiary accounting system or the internal control weaknesses noted above, nor does it provide an adequate basis for reconciling the general ledger with the subsidiary records.

In its Auditors' Report on Internal Accounting Control and Compliance for Hazard Substance Superfund for the fiscal year ended September 30, 1987 (issued September 21, 1988), Leonard G. Birnbaum and Company, the Superfund auditor, reported material weaknesses in EPA's accounting for and controlling personal property. As noted earlier, we utilized its control testing to augment ours. We concur with its findings and recommendations related to personal property. The Superfund auditor's findings can be summarized as follows:

- Amounts recorded in PPAS were not always correct because cost data entered into the property records did not include adjustments for price changes, freight, or discounts, and PPAS was not reconciled to the accounting system as required by title 2.
- Property was not always recorded in the property records because (1) receiving documents were not sent to the Property Accountability Officer when property was ordered or received, (2) there were omissions and delays in entering data into the property records, and (3) computer software was not tracked and capitalized.
- Required physical inventories were not always performed and proper transfer documents were not maintained.
- Custodial officers had not accepted their custodial responsibilities.

The Superfund auditor's recommendations can be summarized as follows:

- EPA should develop a list of all property and equipment disbursements (along with supporting documentation) and reconcile the list to property records to ensure that all appropriate items are recorded in PPAS.
- EPA should establish a policy for capitalizing computer software in accordance with title 2.
- Property Accountability Officers should certify that corrective action has been taken on remaining errors and omissions in PPAS.

EPA's accounting system problems with property are not new. As required by FMFIA, agencies annually review and report on their accounting system, as required by section 4 of the act, and on the adequacy of their systems of internal controls, as required by section 2 of the act. In its initial FMFIA report covering fiscal year 1983, EPA identified the need for an accounting system enhancement to integrate its accounting and property management systems. For fiscal year 1987, while EPA reported a material accounting system weakness with its property accounting, it did not report a material weakness in its internal control system over property. Our review of EPA's property accounting, together with the results of the Superfund auditor, found that material weaknesses existed in both EPA's accounting system for property and the internal control system over property.

Finally, we were unable to perform audit procedures necessary to test the fair presentation of EPA's \$68.3 million in land and buildings because we could not obtain supporting documentation. EPA's subsidiary support for land and buildings consists of files maintained by the Facilities Management and Services Division (FMSD). However, representatives from

FMSD were unable to provide documentation from the files needed to establish ownership, location, age, and cost of land and buildings.

Conclusions

During fiscal year 1987, EPA did not effectively use reconciliation as an internal accounting control, which contributed to material misstatements in Superfund's cash balance as reported in the agency's fiscal year 1986 unaudited reports to Treasury and OMB and to material misstatements in receipts in its fiscal year 1987 Treasury Report on Operations. Also, without periodic reconciliations of the general ledger control accounts to their supporting subsidiary records, management cannot be reasonably assured that transactions are properly recorded and reported and that errors and irregularities are detected and corrected on a timely basis.

EPA's subsidiary accounting system for property and related internal controls do not adequately account for or maintain control over these assets. The agency's efforts to reconstruct its general ledger balance for equipment represents a step toward improving the accounting for property. However, additional actions are needed to improve both the accuracy and reliability of accounting data maintained by the subsidiary records and the internal control environment over agency assets. EPA's internal accounting control weaknesses over property inhibit the proper accounting for and accountability over agency assets. As a result, management is not provided with reasonable assurance that property assets are safeguarded against waste, loss, and unauthorized use or misappropriation.

Recommendations

To ensure that all agency assets and liabilities are properly accounted for and reported, we recommend that the Administrator of the Environmental Protection Agency direct agency staff to:

- regularly reconcile general ledger balances with available subsidiary records, program office records, and external sources, and promptly investigate and resolve any discrepancies;
- ensure that the accounting system provides accurate and reliable financial and management records needed to account for and control property assets;

- address all property-related findings and recommendations reported by the Superfund auditor in its fiscal year 1987 audit report dated September 21, 1988; and
- report the property and reconciliation internal control problems, if applicable, in the agency's fiscal year 1988 FMFIA report.

Except for the weaknesses identified by GAO in this report, by EPA in its FMFIA report, and by Leonard G. Birnbaum and Company in its Auditors' Report on Internal Accounting Control and Compliance, our study and evaluation disclosed no other conditions which we consider to be material in relation to the consolidated financial statements taken as a whole. We considered these weaknesses in determining the nature, timing, and extent of our audit tests. While several GAO and EPA Office of Inspector General reports contain, in our judgment, internal accounting control weaknesses of a programmatic nature, we believe these matters do not have a material effect on EPA's fiscal year 1987 consolidated financial statements. Except for the inadequacies of the accounting system and internal controls related to property which caused us to qualify our opinion on the agency's consolidated statement of financial position and supplemental schedule of financial position by fund activity, the weaknesses in internal accounting controls identified do not affect that opinion.

Other Opportunities for Improvement

During the course of our examination, we identified a number of other weaknesses in internal accounting controls which will be reported separately to the Environmental Protection Agency. Although we did not consider these weaknesses to be material to the consolidated financial statements, they nonetheless merit management's attention.

Agency Comments

We did not request official written comments on this report. However, we presented a draft report on the results of our examination of EPA's financial statements and our study and evaluation of internal accounting controls to responsible EPA officials and have incorporated their comments where appropriate.

EPA officials agreed with our findings regarding the inadequate use of reconciliations as a control procedure. The Deputy Director of the Financial Management Division stated that the weakness has been raised in the Financial Management Division's FMFIA review for fiscal year 1988.

Officials of the Facilities Management and Services Division agreed with our finding of a material weakness in internal controls over property and indicated that the weakness has been raised in the division's FMFIA review. Financial Management Division officials agreed with the internal control and accounting system weaknesses we noted in property and stated that a new integrated financial management system, currently under development, should address the accounting system weaknesses.

Report on Compliance With Laws and Regulations

We have examined the consolidated financial statements of the Environmental Protection Agency (EPA) for the fiscal year ended September 30, 1987, and have issued our opinion thereon. Our examination was made in accordance with generally accepted government auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures, including tests of compliance with laws and regulations, as we considered necessary in the circumstances.

The management of EPA is responsible for the agency's compliance with laws and regulations. In connection with our examination referred to above, we selected and tested transactions and records to determine EPA's compliance with laws and regulations, noncompliance with which could have a material effect on the consolidated financial statements of the agency.

Our review of compliance with laws and regulations, made for the limited purpose described in the preceding paragraph, does not necessarily cover all laws and regulations that EPA is required to comply with. Accordingly, we are expressing an opinion only with respect to those transactions tested. In our opinion, EPA complied with the terms and provisions of laws and regulations for the financial transactions tested that could have materially affected its consolidated financial statements. In connection with our examination, nothing came to our attention that caused us to believe that EPA was not in compliance with the terms and provisions of laws and regulations for those transactions not tested.

Financial Statements

Consolidated Statement of Financial Position

As of September 30, 1987 (Dollars in thousands)

Assets

Funds with U.S. Treasury (note 1)	\$ 10,282,078
Advances, accounts and loans receivable, net (notes 1,3)	93,633
Land, buildings, and equipment, net of accumulated depreciation (notes 1,4)	129,775
Future financing sources	<u>38,171</u>

Total Assets 10,543,657

Liabilities and Equity

Liabilities

Accounts payable and accruals:	
To the public	258,834
To other federal agencies	103,662
Advances (note 1):	
From other federal agencies	14,269
From the public	11,925
Accrued payroll and leave	<u>67,782</u>

Total Liabilities 456,472

Commitments and contingencies (note 6)

Equity of the U.S. Government

Unexpended appropriations:	
Unobligated balances	1,913,682
Unliquidated obligations (note 1):	
Grants and other assistance	7,179,701
Contracts and other	915,158
Invested capital	181,073
Cumulative results of operations	<u>(102,429)</u>

Total Equity 10,087,185

Total Liabilities and Equity \$ 10,543,657

The accompanying notes are an integral part of these statements.

Consolidated Statement of Revenues and Expenses

For the Fiscal Year Ended September 30, 1987 (Dollars in thousands)

Expenses

Grants and other assistance (note 7)	\$ 3,353,538
Contractual services	796,675
Personnel compensation and fringe benefits	584,541
Rent, utilities, and telephone (note 1)	98,944
Travel, printing, supplies, and other expenses	104,647
Depreciation (note 1)	<u>18,838</u>
Total Expenses	<u>4,957,183</u>

Revenues (note 1)

Appropriations expended	4,923,262
Transfers and reimbursements	32,410
Fines, penalties, and other revenues	<u>2,711</u>
Total Revenues	<u>4,958,383</u>

Excess of Revenues Over Expenses	\$ <u>1,200</u>
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The accompanying notes are an integral part of these statements.

Consolidated Statement of Changes in Financial Position and Reconciliation to Budget

For the Fiscal Year Ended September 30, 1987 (Dollars in thousands)

Resources Used:

Operating uses:	
Operating expenses	\$ 4,957,183
Items providing funds:	
Depreciation (notes 1,4)	(18,838)
Loss on property	(8,897)
Decrease in advances, accounts, and loans receivable, net	(21,973)
Increase in accounts payable and accruals	(24,068)
Revenue accounted for as offsetting receipts	<u>(32,124)</u>
Funds used by operations	4,851,283

Nonoperating uses:	
Acquisitions of equipment (note 1)	24,348
Funds transactions excluded from outlays	<u>31,074</u>

Net Resources Used (Budgetary Outlays) 4,906,705

Resources Provided:

Current-year appropriation	5,364,188
Net transfers and other	<u>(57,229)</u>

Net Resources Provided 5,306,959

Increase in U.S. Treasury Funds 400,254

U.S. Treasury Funds, Beginning of Year 9,881,824

U.S. Treasury Funds, End of Year \$ 10,282,078

The accompanying notes are an integral part of these statements.

Notes to Financial Statements

Note 1: Significant Accounting Policies

Entity

EPA was created in 1970 by executive reorganization from various components of other agencies in order to better marshal and coordinate federal pollution control efforts. The agency is generally organized around the media and substances it regulates--air, water, land, hazardous waste, pesticides, and toxic substances.

Basis of Consolidation

EPA's consolidated financial statements are prepared in conformity with generally accepted accounting principles for federal agencies as contained in title 2 of the General Accounting Office's (GAO) Policy and Procedures Manual for Guidance of Federal Agencies.

The accompanying consolidated financial statements of EPA include all accounts under EPA's control which have been established and maintained to account for the resources entrusted to the Agency's management. These accounts, as reflected, are maintained on the accrual basis of accounting. In our financial statements, all material intra-agency balances and transactions have been eliminated in consolidation.

Revenue Recognition and Expended Appropriations

Financing sources are provided through congressional appropriations on an annual, multi-year, and no-year basis. Appropriations may be used to finance operating expenses as well as capital expenditures for land, equipment, and other assets as specified by law. Additional revenue is recognized from services provided on a reimbursable basis, fines levied against nonperforming entities and persons making false claims, and penalties charged to delinquent debtors. Revolving fund revenue is recognized when services have been rendered.

The current budgetary process does not distinguish between capital and operating expenditures. For budgetary purposes, both are recognized as a use of budgetary resources (outlays) as paid. However, for financial reporting purposes under accrual accounting, operating expenses are recognized currently in the statement of operations, while advances, reimbursements, and expenditures for capital and other assets are recognized when consumed, or collected, in EPA

operations. Financing sources for these expenses, which are derived both from current and prior-year appropriations, are recognized on the same basis. The consolidated statement of changes in financial position and reconciliation to budget presents a reconciliation of operating expenses on an accrual basis with cash basis budgetary expenditures. Appropriations for fund activities are recorded as a financing source when expended. Unexpended appropriations are recorded as equity of the U.S. government.

Future financing sources represent annual leave expense accrued as earned in the current period, to be funded in the year leave is taken.

Advances

Advances receivable represent funds paid to employees (such as travel advances), other federal agencies, contractors, and grantees for goods or services; actual spending for goods and services which have not been received; or unspent funds which have not been returned. These advances include an accrual of \$6.7 million representing EPA's estimate of drawdowns by letter-of-credit recipients for which costs have not yet been incurred.

Advances payable represent funds paid to EPA by other federal agencies and grantees to purchase goods and services on their behalf and prior to EPA providing the goods and/or services.

Property and Equipment

Land, buildings, and equipment with a cost greater than \$5,000 and a useful life of 2 years or greater are capitalized. Currently, the Agency's procedure is not to calculate depreciation on buildings or library volumes; on equipment, it is calculated on a straight-line basis over an estimated useful life of 5 years.

Annual, Sick, and Other Types of Leave

Employee's annual leave is accrued as it is earned, and the accrual is reduced as leave is taken. At least once per year, the balance in the accrued leave account is adjusted to reflect current pay rates of cumulative annual leave earned but not taken. Senior Executive Services employees may carry forward an unlimited amount of annual leave from one year to the next. Most other employees may carry forward up to 240 hours. Any excess hours not taken are forfeited unless special approval is granted. Sick and other types of leave are expensed as taken.

Cost Allocation

Indirect overhead costs, consisting of rent, utilities, telephone, etc., are allocated to Superfund and Non-Superfund accounts based upon a formula of direct labor hours using budgeted or actual full-time equivalent personnel, not to exceed the administrative ceiling established by appropriations.

Funds with U.S. Treasury

This total represents all unexpended balances on EPA's accounts with the U.S. Treasury.

Note 2 : Intragovernmental Financial Activities

EPA's financial activities are affected by, and are dependent upon, those of the federal government as a whole. Thus, EPA's financial statements do not reflect the results of all financial decisions and activities applicable to EPA operations, as if it were a stand-alone entity.

- The U.S. Treasury receives, disburses, and holds moneys on behalf of EPA for 53 different account titles or fund types for which EPA has management responsibilities.
- EPA's consolidated financial statements are not intended to report the Agency's proportional share of the federal deficit or of public borrowings, including interest thereon.
- Financing for major construction projects was provided through appropriations. To the extent this financing was obtained through public borrowing by the U.S. Treasury, no interest has been capitalized, since such borrowings are recorded in total by the U.S. Treasury and are not allocated to individual departments and agencies.
- During fiscal year 1987, the majority of EPA's employees participated in the Civil Service Retirement System (CSRS). Contributions to the plan are based on 7 percent of the employees' gross pay, to which EPA made a matching contribution. EPA pension contributions for the year ending September 30, 1987, totaled approximately \$27 million.

On January 1, 1987, the Federal Employees' Retirement System (FERS) was implemented, pursuant to Public Law 99-335. This is a defined contribution retirement plan and is comprised of a Social Security Benefits Plan, a Basic Benefit Plan, and a Savings Plan. Generally, it is mandatory for all employees hired on or after January 1, 1984. Employees hired before January 1, 1984, had the option until December 31, 1987, to elect to transfer coverage from CSRS (extended to June 30, 1988, for extenuating circumstances). Contributions to the plans are based on a percentage of the employees' gross pay. Under the Thrift Savings Plan, employees can also elect additional contributions between 1 and 10 percent of their gross pay and EPA will match up to 4 percent of the employee-elected contribution. EPA also pays 1 percent of the employees' salary into the Thrift Savings Plan. FERS and Thrift Savings employer contributions for the year ended September 30, 1987, totaled approximately \$10.7 million. There is the potential for EPA to incur increased costs due to transfers from CSRS to FERS. However, EPA management does not believe the increase will be material.

EPA matches the employees' FICA and Medicare contributions. FICA and Medicare employer's contributions for the year ended September 30, 1987, totaled approximately \$12.5 million.

EPA does not report CSRS or FERS assets, actuarial present value of accumulated plan benefits, or unfunded liabilities applicable to its employees, since this data is maintained by the Office of Personnel Management and is not allocated to individual departments and agencies.

- The General Services Administration (GSA) provides many services to the EPA, such as procurement and telecommunications, which are charged through interagency billings as goods are shipped or services are rendered.
- The EPA contracts for a wide range of goods and services through interagency agreements with other federal agencies and units of state and local governments (reimbursable only) which, for the fiscal year ended September 30, 1987, amounted to approximately \$102.9 million in expenditures and \$31 million in reimbursements.

Note 3: Receivables

Receivables, as of September 30, 1987, consisted of the following:

Advances

Other federal agencies	\$ 4,897,656	
The public	11,610,806	
EPA employees	<u>652,548</u>	
Total Net Advances		\$17,161,010

Accounts Receivable

Other federal agencies	2,303,204	
The public	84,308,755	
Less: Allowance for doubtful accounts	<u>(61,797,960)</u>	
Total Net Accounts Receivable		24,813,999

Loans Receivable (A, B)

Due through July 31, 2007, at interest rates of up to 6.125 percent	51,297,291	
Interest on loans receivable	<u>360,476</u>	
Total Loans Receivable (including interest)		<u>51,657,767</u>
Total Net Receivables		<u>\$93,632,776</u>

A. The Asbestos School Loans

The Asbestos School Hazard Abatement Act of 1984 (ASHAA), as amended by the Asbestos Hazard Emergency Response Act of 1986 (AHERA), gives EPA the lead responsibility to compile technical information on asbestos, to develop procedures and standards for both public and private local educational agencies (LEAs) to use in

abating asbestos hazards, and to provide financial assistance to LEAs on a school-by-school basis to carry out abatement projects. This financial assistance includes both grants and loans to the LEAs. In addition, AHERA provides authority for the issuance of grants in 1988 and 1989 to states or LEAs to carry out inspections for asbestos-containing material in school buildings and preparation of management plans for school buildings as defined by this Act. Not more than 10 percent of the 1988 and 1989 amounts available under ASHAA may be used for these purposes. Due to the recent nature of loans extended under ASHAA and AHERA, the related collection history was not sufficient to make possible the establishment of a meaningful allowance for doubtful loans receivable. As of September 30, 1987, there were outstanding loans under this Act of \$46,812,306.

AHERA also established a trust fund in the U.S. Treasury, known as the "Asbestos Trust Fund." Repayments of loans must be made to EPA for deposit in the General Fund of the U.S. Treasury. Repayments of Asbestos School Loans totaled \$846,184 for the fiscal year ended September 30, 1987.

B. Puerto Rico Loans

EPA, pursuant to Public Law 97-357 (October 1982), has loaned funds to the Commonwealth of Puerto Rico in the amount of \$16,720,039. These loans were granted as a result of special congressional action to allow certain construction grant unobligated balances to be used as loans to enable the Commonwealth of Puerto Rico to fund five specific regional wastewater treatment systems. These funds may be used by the Commonwealth of Puerto Rico to fund the nonfederal share of the costs of such projects. Interest for these loans is recorded monthly, based on the U.S. Treasury rate established for this loan program. An allowance for doubtful loans receivable was not established for these loans due to the large amount of FY 1987 collections (\$12.2 million) and the immaterial amount of the balance outstanding. As of September 30, 1987, there were outstanding loans for this program in the amount of \$4,484,984.

Note 4: Property and Equipment

Property and equipment, as of September 30, 1987, consisted of the following:

	<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net book value</u>
(Dollars in thousands)			
Land	\$ 3,821		\$ 3,821
Building	64,443		64,443
Equipment	239,038	\$ 190,878	48,160
Library volumes	<u>13,351</u>	_____	<u>13,351</u>
Total	<u>\$ 320,653</u>	<u>\$ 190,878</u>	<u>\$ 129,775</u>

Note 5: Leases

The Agency leases office and laboratory space, copiers and computers from GSA and the public. The Agency also leases laboratory space directly from the lessors. All leases are considered to be operating leases; some may be cancelable without penalty cost and expire at variable intervals. Lease payments during fiscal year 1987 totaled \$94.7 million.

The majority of EPA's office space is leased through GSA, and the majority of the leased laboratory space is leased directly. Rates charged to EPA by lessors are based upon appraisals of comparable space. GSA's rates are approximations based upon these appraisals, while rates for direct leases are negotiated. During fiscal year 1987, EPA did not cancel any leases. EPA does not foresee any termination of leases in the near future.

Note 6: Commitments and Contingencies

Under the Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA), as amended at 7 U.S.C. 136m, EPA is authorized to suspend or cancel registration of pesticides determined to be hazardous. Under certain conditions, EPA makes indemnity payments to owners who suffer losses as a result of such actions. This has the poten-

tial to result in millions of dollars in claims. The continuing resolution for FY 1988 and appropriation bills for FY 1989 specify that during these years, EPA should seek payment for these claims from Treasury's Claims, Judgements, and Relief Acts Fund. As of September 30, 1987, EPA had actual outstanding indemnification claims for two chemicals totaling \$12.5 million, with a possibility of an additional \$27.5 million pending.

Both the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and the Superfund Amendments and Reauthorization Act (SARA) provide for cost-recovery of funds. (See note 7). Potential cost recovery expenditures are expensed because potential collection of these funds is not measurable, and there is no assurance that these funds will be recovered. EPA establishes the account receivable when there is a greater potential (sum certain) in receiving the funds from the responsible party(ies). This is done when a judgement, order of payment, or an agreement is made for payment. Since the inception of Superfund, EPA has collected approximately \$48.6 million in cost-recovery through fiscal year 1987.

EPA is a party in various administrative proceedings, legal actions, and claims brought by, or against, it. These include:

- Under the Federal Tort Claims Act, any award, compromise, or settlement in excess of \$2,500 is paid from the Claims, Judgements, and Relief Acts Fund maintained by the Department of the Treasury, while those of \$2,500 or less are paid by EPA. Payments during fiscal year 1987 for awards, compromises, and settlements resulting from such legal actions amounted to \$25,000 from the Treasury's Claims, Judgements, and Relief Acts Fund, and \$9,568 from EPA.
- Various personnel actions, suits, or claims brought against the Agency by employees and others.
- Various contract and assistance program claims brought against the Agency by vendors, grantees, and others.
- The legal recovery of Superfund costs incurred for pollution cleanup of specific sites, to include the collection of fines and penalties from responsible parties.
- Claims against recipients for improperly spent assistance funds which may be settled by a reduction of future EPA funding to the grantee or the provision of additional grantee matching funds. As of September 30, 1987, approximately

\$33.7 billion of EPA payments to units of state and local governments for construction of wastewater treatment facilities are awaiting audit. EPA believes that recovery of any improperly spent costs will not be material to its financial statements.

In the opinion of EPA's management and General Counsel, the ultimate resolution of legal actions still pending will not materially affect EPA's operations or financial position.

Note 7: Major Activities

Superfund

On December 11, 1980, Congress passed the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA), commonly referred to as "Superfund." This Act created the Hazardous Substance Response Trust Fund, which is administered by the U.S. Treasury. The Trust Fund was established to provide money to respond to actual or threatened releases of hazardous substances, pollutants, or contaminants that may endanger public health or the environment.

The Superfund Amendments and Reauthorization Act (SARA) was enacted October 17, 1986. SARA reauthorized CERCLA for \$8.5 billion to be appropriated over a 5-year period for the continuation of the program launched by CERCLA to clean up hazardous waste sites, strengthen and expand the cleanup program, and change the tax structure for financing the Fund.

Grants and Other Assistance

The Agency, in fulfilling its responsibilities for protecting and enhancing the quality of the environment, provides financial assistance to various public, private, and state recipients in the form of grants and cooperative agreements. Assistance represents the most significant portion of the Agency's appropriation. In fiscal year 1987, the Agency obligated \$2.6 billion for recipients.

At the expiration of an Assistance Agreement, unused or improperly applied funds are either collected from the recipients or appropriately adjusted by an offset, or otherwise utilized in accordance with the conditions of the Assistance Agreement. Arrangements are made for the disposition of property purchased through the Assistance Agreements according to federal regulations.

Supplemental Schedules

The following supplemental schedules provide further detail of, by major fund activity, assets, liabilities, and U.S. government equity; revenue, financing sources, and expenses; sources and uses of funds by major fund activity; and budgeted and actual outlays.

General fund accounts are used to record financial transactions arising under congressional appropriations or other authorizations to spend general revenues. EPA is managing 46 general fund accounts, of which 23 are funded by current-year appropriations, and 9 cannot incur new obligations. The remaining 14 are suspense, receipt, and deposit accounts. In addition, the general fund has been combined with a small certification revolving fund for financial reporting purposes. This revolving fund generated the full amount of the \$1.2 million excess of revenues over expenses on EPA's consolidated statement of revenues and expenses.

Superfund accounts are used to record transactions arising from the fulfillment of EPA's responsibilities under CERCLA and SARA. (See note 7.) The Superfund Trust Fund has been consolidated with two smaller trust funds, the Leaking Underground Storage Tanks Trust Fund and the Miscellaneous Contributed Funds.

Supplemental Schedules

Schedule of Financial Position by Fund Activity

As of September 30, 1987 (Dollars in thousands)

	<u>General fund appropriations</u>	<u>Superfund appropriations</u>	<u>Consolidated balances</u>
Assets			
Funds with U.S. Treasury	\$ 8,921,028	\$ 1,361,050	\$ 10,282,078
Advances, accounts and loans receivable, net	83,865	9,768	93,633
Land, buildings, and equipment, net of accumulated depreciation	120,933	8,842	129,775
Future financing sources	<u>33,524</u>	<u>4,647</u>	<u>38,171</u>
Total Assets	<u>9,159,350</u>	<u>1,384,307</u>	<u>10,543,657</u>
Liabilities and Equity			
Liabilities			
Accounts payable and accruals:			
To the public	210,749	48,085	258,834
To other federal agencies	59,476	44,186	103,662
Advances:			
From other federal agencies	710	13,559	14,269
From the public	1,566	10,359	11,925
Accrued payroll and leave	<u>57,963</u>	<u>9,819</u>	<u>67,782</u>
Total Liabilities	<u>330,464</u>	<u>126,008</u>	<u>456,472</u>
Equity of the U.S. Government			
Unexpended appropriations:			
Unobligated balances	1,409,681	504,001	1,913,682
Unliquidated obligations:			
Grants and other assistance	6,937,027	242,674	7,179,701
Contracts and other	385,034	530,124	915,158
Invested capital	172,231	8,842	181,073
Cumulative results of operations	<u>(75,087)</u>	<u>(27,342)</u>	<u>(102,429)</u>
Total Equity	<u>8,828,886</u>	<u>1,258,299</u>	<u>10,087,185</u>
Total Liabilities and Equity	<u>\$ 9,159,350</u>	<u>\$ 1,384,307</u>	<u>\$ 10,543,657</u>

Supplemental Schedules

Schedule of Revenues and Expenses by Fund Activity

For the Fiscal Year Ended September 30, 1987 (Dollars in thousands)

	<u>General fund appropriations</u>	<u>Superfund appropriations</u>	<u>Consolidated balances</u>
Expenses			
Grants and other assistance	\$ 3,310,592	\$ 42,946	\$ 3,353,538
Contractual services	423,210	373,465	796,675
Personnel compensation and fringe benefits	494,546	89,995	584,541
Rent, utilities, and telephone	84,535	14,409	98,944
Travel, printing, supplies, and other expenses	48,048	56,599	104,647
Depreciation	<u>15,881</u>	<u>2,957</u>	<u>18,838</u>
Total Expenses	<u>4,376,812</u>	<u>580,371</u>	<u>4,957,183</u>
Revenues			
Appropriations expended	4,343,800	579,462	4,923,262
Transfer and reimbursements	31,501	909	32,410
Fines, penalties, and other revenues	<u>2,711</u>	<u>0</u>	<u>2,711</u>
Total Revenues	<u>4,378,012</u>	<u>580,371</u>	<u>4,958,383</u>
Excess of Revenues Over Expenses	<u>\$ 1,200</u>	<u>\$ 0</u>	<u>\$ 1,200</u>

Schedule of Changes in Financial Position and Reconciliation to Budget by Fund Activity

For the Fiscal Year Ended September 30, 1987 (Dollars in thousands)

	<u>General fund appropriations</u>	<u>Superfund appropriations</u>	<u>Intra-Agency eliminations</u>	<u>Consolidated balances</u>
Resources Used:				
Operating uses:				
Operating expenses	\$ 4,376,812	\$ 580,371	\$ 0	\$ 4,957,183
Items requiring (providing) funds:				
Depreciation	(15,881)	(2,957)		(18,838)
Loss on property	(7,846)	(1,051)		(8,897)
Increase (decrease) in advances, accounts, and loans receivable, net	(24,495)	2,522		(21,973)
Decrease (increase) in accounts payable and accruals	32,437	(56,505)		(24,068)
Revenue accounted for as offsetting receipts	<u>(26,329)</u>	<u>(5,795)</u>		<u>(32,124)</u>
Funds Used by Operations	4,334,698	516,585	0	4,851,283
Nonoperating uses:				
Acquisitions of equipment	19,378	4,970		24,348
Interfund transfers	650,000	0	(650,000)	0
Funds transactions excluded from outlays	<u>28,570</u>	<u>2,504</u>		<u>31,074</u>
Net Resources Used (Budgetary Outlays)	5,032,646	524,059	(650,000)	4,906,705
Resources Provided:				
Current-year appropriation	4,552,869	1,461,319	(650,000)	5,364,188
Net transfers and other	<u>1,991</u>	<u>(59,220)</u>		<u>(57,229)</u>
Net Resources Provided	<u>4,554,860</u>	<u>1,402,099</u>	<u>(650,000)</u>	<u>5,306,959</u>
Increase (decrease) in U.S. Treasury Funds	<u>(477,786)</u>	<u>878,040</u>	<u>0</u>	<u>400,254</u>
U.S. Treasury Funds, Beginning of Year	<u>9,398,814</u>	<u>483,010</u>	<u>0</u>	<u>9,881,824</u>
U.S. Treasury Funds, End of Year	<u>\$ 8,921,028</u>	<u>\$ 1,361,050</u>	<u>\$ 0</u>	<u>\$ 10,282,078</u>

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